BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

IN THE MATTER OF	)	
	)	
DEVELOPING A UNIFIED INTERCARRIER	)	CC DOCKET NO. 01-92
COMPENSATION REGIME	)	

COMMENTS OF

TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

CONSUMER FEDERATION OF AMERICA

CONSUMERS UNION

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July 20, 2005

THE PROPOSALS BEFORE THE COMMISSION LACK EVIDENTIARY AND LEGAL JUSTIFICATION

In our initial comments, the Texas Office of Public Utility Counsel, the Consumer Federation of America and Consumers Union urged the Commission to reform access charges in a manner that recovers the actual cost of providing access from the users of access services. We noted that the proposals offered to the Commission on an *ad hoc, ex parte* basis violated this basic principle. The proposals pushed by the largest groups of firms in the industry in the initial round of comments continue to press for illegal, economically irrational revenue replacement schemes that would result in an unjust and unreasonable shift of a substantial part of the burden onto low volume and lower income residential consumers. Exhibit 1 demonstrates the fundamental difference between the industry proposals and those offered by consumer representatives.

Cost Recovery

The Commission cannot adopt any of the proposals before it. Nor can it cobble together an access charge regime by mixing and matching piece parts of the proposals because they generally lack the most basic foundation of any principled ratemaking, ***cost justification***. Access reform should start with the fundamental principle of cost causation. Costs of access should be identified.

The proposals put forward by the dominant firms in the industry must also be rejected because they are blatantly illegal in two of their most critical features. First, they would impose a bill and keep regime on telecommunications companies, where *Congress expressly precluded the imposition of such a mandatory program*.

A number of commenters recognize that as "a statutory and a policy matter, carriers must bear the cost of putting traffic on other carriers' networks… and any mandatory bill-and-keep scheme would violate the Act, the Commission's rules, and sound policy. As a legal matter, the relevant incumbent LEC's TELRIC cost of providing transport and termination is a reasonable minimum for all carriers."[1]

Jurisdictional Authority

Second, several of the proposals by the industry urge the Commission to seize control over intrastate rates that are *expressly beyond its ratemaking authority.* There is a recognition among many that the desire to have uniform rates must recognize the jurisdictional authority of states to set intrastate rates. Even those who advocate unification of intrastate and interstate rates recognize that

> the Commission should avoid to the extent possible efforts to utilize its forbearance and preemption powers as it moves to unify the existing disparate intercarrier compensation regimes. Indeed, as the Commission outlines in the FNMPRM, serious legal questions exist regarding whether the Commission may forbear from section 251(b)(5) or utilize preemption to harmonize intrastate access charges with other jurisdictional forms of intercarrier compensation.[2]

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[1] KMC Telecom, Inc. and Xspedius Communications, LLC, p. 30. Unless otherwise noted, all references are to initial comments filed in this proceeding.

[2] KMC Telecom, Inc. and Xspedius Communications, LLC, pp. 64-65.

The legal basis for state jurisdiction is consistent with the empirical reality of the telecommunications industry. Just over 500 billion calls were placed in 2003 and almost 90 percent were intrastate.[3] Similarly, approximately 80 percent of the calls placed by residential wireless users were intrastate.[4] Thus, telephone service remains an intrastate activity on the demand side.

On the supply-side, it is simply impossible to complete a call without a local access medium. Thus, there is neither a legal nor an economic basis for the FCC to preempt the states in setting rates for access services.

Ignoring the Public in the Public Interest

Moreover, the proposals are devoid of evidence on one of the central public policy criteria that the Commission is charged by Congress to consider, *the impact on ratepayers.*

The initial comments have not presented an evidentiary basis to support their plans. As several CLECs noted about the most prominent proposal. "Although the ICF goes into great detail regarding the practical working of its plan, ICF (by design) offer little if any discussion of how its plan jibes with the Act, the Commission's rules, and the policy goals articulated by the Commission."[5]

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[3] Industry Analysis and Technology Division Wireline Competition Bureau, *Trends in Telephone Service,* table 10.2.
[4] *Trends in Telephone Service,* table 10.2.
[5] KMC Telecom, Inc. and Xspedius Communications, LLC, p. 39.

Ultimately, all of the plans are wide of the mark because they promote the private interests of a small group of companies at the expense of the public interest.

MetroPCS Communications, Inc., a small urban wireless service provider, offers a telling comment on the industry proposal to radically alter intercarrier compensation.

> Wireless carriers appear to be under-represented in the ICF group. As a result, the ICF Plan must be carefully reviewed to assure that it does not reflect an anti-CMRS bias. MetroPCS notes in this regard that one major independent wireless carrier, T-Mobile USA, Inc. ("T-Mobile"), which actively participate in the ICF discussions, decided <u>not</u> to become a signatory to the ICF Plan. In addition, on December 21, 3004, T-Mobile filed a letter raising certain questions about the fairness of the ICF Plan to CMRS carriers.[6]

SureWest, a small, non-rural, ILEC offers another important observation. "Moreover, none of the proposals has been supported by backup data at a level of detail sufficient to allow evaluation of the impact of the plan on industry and end users."[7]

The Ad Hoc Telecommunications Users Committee, a group of nineteen very large consumers of telecommunications users, fourteen of whom are in the Fortune 500, echoes the SureWest concern, and pinpoints the ultimate cause of the lack of comment on consumer impacts. "While much of the *FNPRM* focuses on the effects of various approaches to intercarrier compensation and wholesale

[6] MetroPCS Communications Inc., p. 13.
[7] SureWest Corporation, p. iii.

relationships, little in the *FNPRM* discusses the impact on end users."[8] Perhaps commenters failed to address the impact on consumers of the proposal because the Commission devoted little if any attention to this question.

Taken together these observations highlight the fundamental flaw in the proposals put before the commission. The public has been left out as each industry group sought to craft a proposal that would promote the interests of a few companies at the expense of the public and other parts of the industry.

We sympathize with the complaint of the small wireless carriers and large business users, but consider the plight of the small residential consumer. Not one representative of residential consumer interests participated in any of the groups developing proposals. Residential consumers were completely unrepresented in the ICF group. As a result, the ICF Plan embodies a thoroughly anti-consumer bias. Each of the sectors and companies that stuck with the ICF negotiations defended its interests and, when money was necessary to buy someone off to effectuate a compromise, the ICF Plan took it out of the consumer's pocket. That was the easy way to go, since there were no consumers in the room to protests or to quit the negotiations when they became antithetical to the consumer interest.

ACCESS CHARGES MUST RECOVER REAL COSTS

[8] Ad Hoc, p. 1.

The industry desperately needs access charge reform, but the self-interested industry proposals are not a reasonable basis to proceed and they will not lead to a stable environment for the industry any time soon. The Commission must conduct a thorough cost proceeding, establish rates that recover the cost of access and design a cost recovery approach that promotes universal service.

One of the primary reasons that access charges have ended up in such a Hodge Podge mess is precisely the fact that the Commission has been unwilling to do its homework and take on the challenge of analyzing the underlying costs. There are no shortcuts to genuine reform at this stage. The Commission will only succeed if it builds its reform effort on the correct foundation, the forward-looking cost of access. Without such an analysis, "the Commission has no reasonable basis on which to assess the LECs current level of earnings or their projected earnings after implementation of new intercarrier compensations rules."[9] The Commission cannot establish a unified access charge system without establishing a non-zero price for access because there are nontrivial costs associated with access.

The Notice and the comments are virtually devoid of any discussion of the most important element of the access charge and reciprocal compensation regimes – that actual cost of providing the services. Access charge reform must start with a rigorous analysis of the costs caused by terminating traffic on interconnected networks. Ironically, the Notice makes repeated reference to

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[9] Ad Hoc, p. 13.

technologies that change the cost structure of telecommunications, but never considers whether those changes might also lower costs.

The last time the Commission reformed access charges, it swept the cost evidence under the rug – sidestepping the issue of audits,[10] and universal service payments to large incumbent LECs. As it proposes to roll up the rug once and for all with a genuine reform, it must confront all of the dirty little secrets it has tried to hide and ignore.

It must reduce the amount of interstate revenue collected under the guise of access charges in excess of the forward looking economic costs of providing services. Only by squarely confronting the cost analysis can it execute its duty of ensuring that rates are just and reasonable.

If the Commission does so, it will find that access charges can be lowered substantially, without any increase in fixed monthly charges for the large urban LECs. It will also moderate the need to collect universal service funds to preserve the affordability of service in rural and high cost areas. As the Ad Hoc Committee argued, "There is no evidence that local exchange carriers would be unable to earn reasonable rates of return if the Commission adopts an intercarrier compensation model that significantly reduces access charges."[11]

Many commenters share this view, pointing out that access charge reform must not be a simple make whole exercise, but must rest on a thorough analysis

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[10] Teletruth, p. 2 .
[11] Ad Hoc, p. 11.

to the costs underlying access charges, if this reform is to promote economic efficiency through a legally sustainable rate structure.

Ad Hoc lists the steps necessary as the foundation of reform of the access charge regime.

> Carriers claiming to need to recover costs, should be required to make showings that include, but may not be limited to, (1) Allocation of costs between regulated and unregulated services and between the intrastate and the interstate jurisdictions, (2) the usage sensitive access revenues lost as a result of a new intercarrier compensation regime, (3) the demand stimulation effect of lower access charges, (4) the revenue effect of increased line charges authorized by the Commission, (5) other possible rate changes and their effect on revenues, (6) anticipated revenues and earnings after implementation of new intercarrier compensation rules, taking into account all carrier revenues and earnings, and (7) the rate of return deemed reasonable given the risks and market conditions confronting the carrier.[12]

David Gabel's affidavit, on behalf of NASUCA, in this proceeding addresses both of the critical aspects of costs – that they have been declining and that there are substantial, usage driven costs in the network. The full effects of digitalization of the network have never been taken into account in the federal jurisdiction; nor have the increasing density of central offices and the deployment of fiber. Each of these factors lowers costs significantly.

Moreover, on a going forward basis several of the proposals incorrectly index flat rate charges to inflation, when the cost of telephone service have never, in its entire history mirrored the rate of inflation. As a dynamic, high tech industry, productivity has reduced the real costs of telephone service. In order to

[12] Ad Hoc, p. 12.

ensure that rates are just and reasonable, it must ensure that consumers receive a share of the productivity gains in the industry.

COMPETITION CANNOT BE RELIED UPON TO DISCIPLINE ACCESS CHARGES

The Commission cannot rely on "competition" to squeeze out excess revenue and make consumers whole because competition in access is simply insufficient to do the job. The record in this proceeding contains two clear examples in which the Commission asserted that competition would do the job and it has failed consumers.

The Ad Hoc Committee points out that special access was one of the first areas where the Commission thought, incorrectly, it could rely on competition

> In various places throughout the FNPRM the Commission questions whether it can rely upon competition to set and regulate interconnection prices, and any alternative recovery mechanism used to compensate LECs for reduced interconnection charges (e.g., SLCs, USF). The answer to both of these questions is a resounding "no." As Ad Hoc demonstrated in its August 2004 white paper, *Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets,"* real and/or potential competition has not been sufficient to discipline LEC pricing practices to date.[13]

Analyses of special access presented to the Commission in ongoing proceedings[14] paint a very troubling picture of rising prices and declining costs,

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[13] Ad Hoc, p. 8.

[14] Reply Declaration of Lee Selwyn, *AT&T Petition for Rulemaking to Reform Regulation of ILEC Rates for Interstate Special Access Services*, ¶ 18 (FCC RM No. 10593 (filed on behalf of AT&T Corp. Jan. 23, 2003).
Reply Comments of Ad Hoc Telecommunications Users Committee, *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control,* Federal Communications Commission, WC Docket No. 05-75, DA 05-762, May 24, 2005; Ex Parte of BT,

exactly the opposite of what one would expect in a competitive market (see Exhibit 2). The exhibit shows a sharp increase in the rate of return on special access as a result of constant pricings and sharply declining costs. The decline in costs is on the order of 40 percent in the seven years after the passage of the 1996 Act, or an annual decline of about 7 percent per year.

NASUCA offer a similar observation on the failure of competition with respect to increases in subscriber line charges.

> Proponents of increasing the SLC argue that the SLC would be capped, and would be subject to competitive pressures. These were the same arguments put forward five years ago in the *CALLS* proceeding to justify an increase in the SLC cap to $6.50.
>
> Actual experience with the SLC has shown that it is immune to competition and operates as a pricing umbrella, allowing competitors to impose an additional charge on consumers in the guise of a government-imposed surcharge.[15]

NASUCA finds that almost all of the competitors impose a SLC equal to or greater than the SLC imposed by the incumbent (see Exhibit 3).

THE NATURE OF COSTS

The bill and keep proposals being pushed by a number of commenters are based on an erroneous view of costs. NASUCA presents evidence that challenges the claim that switching costs are not traffic sensitive, concluding "It is clear that the level of expected usage, and not merely the number of lines connected to the

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"SBC Communications, Ind. And AT&T Corp. Applications for Approval of Transfer of Control," May 6, 2005.

[15] NASUCA, p. 30.

switch, is driving costs…. For both packet and circuit switching, the amount of equipment installed in an office is a function of busy-hour traffic load.[16]

Time Warner, et al. reach a similar conclusion, "It is clear that the transport and termination functions performed by wireline and wireless networks include substantial usage-sensitive costs that are only increasing as wireless and DLC and fiber-loop architectures become the norm."[17] Interestingly, Time Warner, et al, note that the dominant ILECs recently argued exactly the same thing. In early 2004, SBC rejected "The CLECs claim that switching costs are almost exclusively non-traffic sensitive… That is false… [T]he amount of capacity the incumbent purchases at the outset is of course dependent on its best estimate of future usage, and all usage the incumbent the serves contributes to the potential exhaust of the switch's capacity."[18] Similarly, in late 2003, Verizon argued that "switch processor and memory costs vary with usage. Switch processing resources are engineered and sized prior to deployment based on the amount of expected future use. When an incumbent purchases a switch processor, the size of the switch processor depends on how much traffic the incumbent expects the switch to carry."[19]

Time Warner, et al, assert that the share of traffic sensitive costs is increasing, and NASUCA presents evidence to support this claim because "an

[16] NASUCA, pp. 11-12.
[17] Time Warner Telecom, Conversent Communications Inc., Cbeyond Communications LLC, and Lightship Telecom, p. 14.
[18] Cited in Time Warner, et al., p. 12.
[19] Cited in Time Warner, et al., p. 12.

increasing percentage of customers are connected to the switch via digital line carrier…This is significant because … the number of DS-1s ultimately required is a function of buy hour traffic generated at the remote terminal, not the number of end use lines connected to the remote terminal."[20] Exhibit 4 summarizes the results of the NASUCA engineering model.

Looking out to the next generation networks that will rely on packet switching, NASUCA demonstrates that "the net generation packet switching network is likely to be more capacity-sensitive, and capacity-constrained, than the traditional PSTN. This fact alone makes adoption of bill-and-keep pricing for intercarrier transactions an irrational choice." [21]

These observations on costs are important not only because they demonstrate bill and keep, with its implicit zero price, is irrational, but also because it establishes that if a move to capacity charges, as opposed to usage charges, is contemplated, they must be based on shares of peak hour capacity. Also, when contemplating the recovery of universal service funds, the efficient approach is not telephone numbers, but capacity. Since broadband connections will be driving usage and costs, they should be assessed at a higher rate than narrowband connections.

CONSUMER IMPACTS

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[20] Gable, p. 17.
[21] Gable, p. 26.

Under the ICF Plan and many other industry plans, all of the burdens of lost revenues fall on the backs of the end-users without any attempt to cost justify the revenue levels; all of the benefit goes into the pockets of the industry. In theory, competition might force these reduced costs to be passed through to consumers, in reality that is far from certain. Consumers, who will bear the heaviest burden of rate increases, low and middle income consumers, are least likely to be the targets of competition, where it exists. They will see their basic monthly bills rise substantially, by more than 15 percent on average, and they are not likely to see offsetting reductions in their long distance bills.

The Commission cannot implement the radical changes in intercarrier compensation without much greater detail on the actual impact of any proposal on consumers and companies. The elimination of intercarrier compensation sought by wireless providers cannot possibly be passed through to the 45 percent of households that do not have wireless service.[22] Nor can the two-thirds of the public that does not have broadband benefit from the competition from VoIP that the industry commenters speculate about.[23]

Exhibit 5 presents the penetration of wireless and broadband across income categories from the Current Population Survey Internet supplement. The exhibit assumes a 50 percent increase in broadband penetration within each category since September 2003, which reflects the overall growth of broadband.

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[22] T-Mobile, p. 2.
[23] T-Mobile, p. 3.

This is likely to overstate the level of penetration in the lower income groups, which makes the exhibit a very conservative estimate of how skewed the benefits of the elimination of access charges would be. In the September 2003 survey, 55 percent of households had wireless services, a percentage that is similar to current levels. Recent growth in the number of wireless accounts represents second phones in households that already had one.

The majority of households with incomes below $35,000 per year are not likely to see any benefit from the intermodal competition that the industry commenters tout. Less than half of these households have wireless service and less than one-fifth have broadband. These low and lower middle income households represent almost 40 percent of all households. While two-thirds of middle-income households (incomes between $35,000 and $75,000) have wireless, only one-third have broadband, so the likelihood that competition will force the pass through of benefits to these households is not high.

The record is completely devoid of bill impact analysis, for obvious reasons (see Exhibit 6). The proposed increase in the subscriber line charge represents an increase of over 7 percent in the bill for low-income households (the bottom quintile) and five percent for lower middle-income households (the second quintile). The bottom quintile (lower income households) in the current population survey is approximately those with incomes below $20,000. The second quintile (lower middle income) has incomes roughly between $20,000 and $35,000. The increase in the bill that the rise in SLC charges represents declines rapidly until the top quintile, where it is less than a 3 percent increase in the bill. If we add in the new universal service charge, which will be a per line basis, the total increase in the bill for lower income households would be about 10 percent, while that for lower middle-income households will be about 7 percent.

No guarantees about pass-throughs or price reductions are offered. As we have shown, to the extent competition mitigates these impacts, it will redound to the benefit of upper income households. The net effect will be a huge transfer of wealth from low and lower middle-income households to telephone companies and, perhaps, upper income households and business users.

An Alternative Approach to Access Reform that Eliminates Arbitrage While Preserving Affordability

If there is to be a unified access charge regime, it should be done on a cooperative basis. In fact, commenters who urge a unified regime but recognize the FCC's lack of legal authority urge a cooperative approach. Unfortunately, few of the suggested cooperative approaches provide specifics.

NASUCA recommends an incentive to induce states to move their costs into alignment with the Federal rates. The fund, of $200 million, is small, however, compared to intrastate shift of funding of about $1 billion.[24] It also leaves switched access rates at about twice the generally agreed upon level of cost. NASUCA also assumes that non-rural LECs will not be able to justify revenue replacement. The proposal eliminates about $1 billion in access charges.

[24] NASUCA, p. 21.

Given the necessity of conducting a cost proceeding, we believe that it is premature to pick numbers. The Commission should establish the goal of reducing switching to cost in the federal jurisdiction and commence the cost proceedings necessary to establish just and reasonable revenues for access. The goals of the Commission to establish a uniform rate, which will eliminate distortions, can be accomplished on a state-by-state basis. As long as all calls that the LEC terminates for others are charged as a uniform rate, the opportunity for arbitrage will be eliminated. The uniform per minute termination charge will consist of two elements, a cost element and a universal service element. Eliminating the opportunity for arbitrage with a uniform rate within a state is effective because of the local nature of termination.

The *quid pro quo* for allowing a universal service element to be assessed on interstate minutes would be a requirement that the state conduct a cost proceeding that parallels the federal proceeding. The state could be required to recover a portion of the universal service costs in local rates or state universal service funds. However, there is no reason to preclude states from recovering costs or universal service funds in a uniform rate element on all switching within the state. A uniform rate on all switching would be competitively and technologically neutral – applying to all minutes terminated in the state. This would eliminate the arbitrage problem and the loophole that various telecommunications service providers have been avoiding. The level playing field would also promote the goal of universal service.